

Message Text

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TO AMEMBASSY PORT OF SPAIN

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C O N F I D E N T I A L STATE 274454

E.O.11652:GDS

TAGS: EMIN EINV

SUBJECT: TRINIDAD ALUMINUM SMELTER PROJECT

1. IN DISCUSSIONS WITH OFFICIALS OF THREE GOVERNMENTS ENGAGED IN PLANNING JOINT ALUMINUM SMELTER PROJECT IN TRINIDAD, EMBASSIES MAY AT THEIR DISCRETION DRAW UPON ANALYSIS OF SMELTER'S ECONOMIC FEASIBILITY MADE BY COMMODITIES RESEARCH UNIT, LTD., (CRU), HIGHLY REGARDED LONDON FIRM OF METALS TRADE AND INDUSTRY CONSULTANTS. CRU STUDY, COMMISSIONED BY OPIC, WILL BE POUCHED TO ADDRESSEE POSTS SHORTLY. PENDING DETERMINATION OF TIMING AND METHOD OF RELEASING THIS REPORT, EMBASSY COMMENTS DRAWING UPON ITS CHAPTER ON TRINIDAD SMELTER SHOULD NOT REPEAT NOT BE ATTRIBUTED TO SOURCE. IT IS SUGGESTED THAT COMMENTS BE EXPRESSED IN TERMS OF QUESTIONS RAISED BY EXPERT ANALYSIS AS NOTED BELOW.

2. CRU USES CONSERVATIVE BASES FOR ESTIMATING OPPORTUNITY COSTS OF GAS USED TO GENERATE ELECTRICITY IN TRINIDAD, YIELDING POWER
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COST ADVANTAGE OF TRINIDAD SMELTER V. NEW SEMLTER IN UNITED

STATES OF 2.1 CENTS PER POUND OF ALUMINUM. IT ATTRIBUTES ONE-HALF OF REVISED \$15 MILLION ESTIMATE FOR POINT LISAS INDUSTRIAL ESTATE DEVELOPMENT AND \$2 MILLION IN OTHER INFRASTRUCTURE COSTS TO SMELTER, ESTIMATES 5 PERCENT ADDITIONAL COST OF CAPITAL EQUIPMENT INSTALLATION IN TRINIDAD V. U.S. COSTS, AND ASSUMES ONLY 10 PERCENT DISCOUNT RATE FOR CAPITAL FUNDS IN BOTH TRINIDAD AND US, YIELDING NET CAPITAL DISADVANTAGE FOR TRINIDAD SMELTER OF 0.7 CENTS PER POUND OF ALUMINUM. TRINIDAD WILL HAVE AN EXTRA COST PENALTY ON TRANSPORT AND PORT HANDLING OF ABOUT 1.5 CENTS PER POUND OF ALUMINUM, COMPARED WITH US SMELTER. LABOR COST ADVANTAGE IN TRINIDAD WILL BE ABOUT 1.5 CENTS PER POUND. THUS NET COST ADVANTAGE OF TRINIDAD SMELTER APPEARS TO BE ABOUT 1.3 CENTS PER POUND, A DIFFERENTIAL WITHIN MARGIN OF FORECASTING ERROR AND EASILY OFFSET BY ASSUMING HIGH DISCOUNT RATE ON CAPITAL IF DEVELOPMENT BANK FUNDS ARE NOT AVAILABLE TO CARIBBEAN PARTNERS.

3. THIS NARROW THEORETICAL COST ADVANTAGE TAKES NO ACCOUNT OF SERIOUS TECHNICAL AND MARKETING RISKS. IF SUPPLIER OF TECHNOLOGY IS AN EXPERIENCED OPERATOR IN THE INDUSTRY AND HAS DIRECT EQUITY STAKE IN SUCCESS OF THE PROJECT, EXPENSIVE DELAYS AND COST OVERRUNS ARE LESS LIKELY. THIS CONDITION IS BEING REJECTED BY CARIBBEAN PARTNERS. MARKETING RISKS ALSO GREAT IN THAT AN INDEPENDENT SMELTER MUST SELL IN NARROW AND VOLATILE MARKET. ALTHOUGH IT COULD BE PROFITABLE IN TIMES OF SHORTAGE, IT WOULD SUFFER DISPROPORTIONATELY AT TIMES OF MARKET WEAKNESS AS IT LACKS ASSURED MARKETS.

4. INDEPENDENT SMELTER ALSO HAS COMPETITIVE DIADVANTAGE IN THAT EXISTING PRODUCERS PRICE ALUMINUM ON BASIS OF AVERAGE COST OF CAPITAL IN THEIR EXISTING AND PARTIALLY DEPRECIATED PRODUCTION SYSTEMS, WHICH ARE FAR LOWER THAN CURRENT COST OF NEW PRODUCTION CAPACITY. THUS, COMPARATIVE COSTS OF NEW SMELTER IN TRINIDAD V. NEW SMELTER IN UNITED STATES, SUMMARIZED IN PARA 2 ABOVE, CONSIDERABLY OVERSTATE AVERAGE COST OF ALUMINUM TO BE ESTABLISHED US PRODUCER UNDERTAKING TO BUILD IDENTICAL NEW SMELTER IN UNITED STATES.

5. IN CRU'S JUDGMENT THESE FACTORS FAR OUTWEIGH SMALL AND, AS EXPLAINED ABOVE, THEORETICAL COST ADVANTAGE OF TRINIDAD SMELTER. THEREFORE, WHEREAS TRINIDAD MIGHT BE RATIONAL LOCATION FOR NEW

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SMELTING FACILITIES ON BEHALF OF ESTABLISHED ALUMINUM PRODUCER, A COMPLETELY INDEPENDENT VENTURE PROBABLY WILL DEPEND ON SUBSIDIES BY THE THREE PARTICIPATING GOVERNMENTS. SUCH SUBSIDIES COULD TAKE FORM OF TRINIDAD'S SUPPLYING POWER AND INFRASTRUCTURE AT EVEN LOWER CHARGE TO SMELTER THAN ASSUMED IN PARA 2 AND JAMAICA'S AND GUYANA'S WAIVING PART OR ALL OF BAUXITE LEVIES ON ALUMINA THEY SUPPLY TO SMELTER. DEGREE OF SUCH CONCESSIONS WULD DEPEND ON EXTNET OF TECHNICAL AND MARKETING DIFFICULTIES ENCOUNTERED.

FROM TRINIDAD POINT OF VIEW, SUCH MAY BE JUSTIFIED AS MEANS
OF USING NATURAL GAS IN SOMEWHAT MORE LABOR-INTENSIVE WAY THAN
CONVERTING IT TO LNG OR FERTILIZER.
FROM JAMAICAN AND GUYANESE
POINT OF VIEW, EXPERIENCE IN SMELTER SECTOR MAY GIVE THEM
INDEPENDENT CHECK ON MAJOR COMPANIES' MARKET AND PRICING POLICIES.
THESE CONSIDERATIONS MAY PLACE IN PERSPECTIVE THE VERY REAL
COMMERCIAL PROBLEMS THE THREE GOVERNMENTS FACE IN THIS PROJECT.
END SUMMARY.

6. WE WOULD BE INTERESTED TO KNOW WHETHER EXTENT OF LIKELY SUBSIDIES
AND MEANS OF ASSURING EQUALITY IN BEARING THIS BURDEN HAVE
BEEN FULLY CONSIDERED BY THREE GOVERNMENTS. KISSINGER

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